

Focus: Public sector outsourcing

# The Age of Austerity

Government cutbacks have led some to predict a 'golden age' for outsourcing. If it arrives, says **Chris Middleton**, that pot of gold may be more of a poisoned chalice.

**J**une 22, 2010 was D-Day for the public sector; it was the day Chancellor George Osborne rose to his feet to deliver the British Government's emergency budget, slashing an initial £6.2 billion from public spending to counter the £155 billion deficit. (Some claim the deficit is nearer £1 trillion, including off-balance sheet liabilities.) Osborne announced 25% cuts across public financing. Days later, a leak suggested that he was asking some departments for 40% savings.

In July, Prime Minister David Cameron flew to India as part of a strategy to renew the UK's 'special relationship' there. "In terms of being open to outsourcing... you will find Britain one of the most open and progressive countries," he said during a visit to Infosys Technologies' campus. Some will view the Prime Minister's public wooing of Indian business as a signal to 'let outsourcing begin'. It will: but not in quite the way many believe.

The extent of the cuts quickly brought to light the disengagement of some vendors with contemporary politics. On July 20, £300 million was wiped off the market capitalisation of Cable & Wireless Worldwide (CWW) after a profit warning.

The company provides communications services to several Whitehall departments. "Non-contracted spending in the UK public sector has slowed very significantly," said the warning. "Given the nature of our public sector business, this reduction will adversely impact trading in the current year." CEO Jim Marsh added: "What has surprised us is the speed this was put into action." That was an extraordinary statement for a business leader to make: the speed of the cutbacks was the defining issue of a long election campaign.

#### Calling on all channels

Ironically, the day after CWW's warning national communications regulator Ofcom announced that it anticipated cost savings of £7.5 million over five years via a new outsourcing deal with Logica to overhaul its ICT systems. The contract includes improved support for the 300,000 contacts Ofcom receives annually from, among others, the telecoms and broadcast industries. It is not known if any of those calls are from Jim Marsh.

So these are the twin themes of outsourcing in the Age of Austerity. The new public sector is a two-headed dog that both barks and bites. One head barks that it

**"The new public sector is a two-headed dog that barks and bites. One head barks that it needs help, the other bites when vendors are complacent."**



**The Chancellor: Osborne may slash as much as 40% from Government spending.**

Photo: Press Association

needs help, efficiency and swift delivery; the other bites when vendors are too entrenched and complacent to notice the shrinking perimeters.

But if that dog is no longer there to be wagged by the big consultancies, as New Labour sometimes was, many outsourcers seem unaware of the Government's change in mood; all the talk at trade shows is of a 'golden age' for services. So who is right?

#### Micro versus macro

First, it seems likely that any bonanza of new business will take place at the micro level – dozens of smaller, local authority contracts have already been reported – rather than at the macro level of 'big Government'. In large-scale Government contracts, major changes are afoot, while renegotiation is rife across existing deals of all sizes. So the mood in Whitehall is clear: this is about efficiency, not private-sector profit; low-cost deals that can be offshored, not a UK services boom.

At the macro level, public sector cutbacks are a massive challenge for the outsourcing industry because five Government bodies – the Department for Work and Pensions (DWP); the Ministry of Defence (MoD); the Department for Health; Her Majesty's Revenue & Customs (HMRC), and the Ministry of Justice – are among the top 10 users of IT in the country. The Royal Mail is the ninth largest. When 60% of the UK's largest IT customers are essentially public sector, then wholesale renegotiation means plunging margins.

#### Creating the job you lost

There are other challenges too. In July, *The Guardian* reported that Osborne's austerity budget will result in the loss of up to 1.3 million jobs across the economy over the next five years, according to a private Treasury assessment of the planned cuts. The Government itself is banking on two million new private sector jobs fuelling economic recovery, but few economists believe those figures.

A possible explanation is that Cameron plans to strip functions out of Whitehall and



#### • CSC

Before the election, CSC, one of the lead contractors to the NHS National Programme for IT (NPFIT), was negotiating new terms with the Labour Government, a process complicated by the provider missing a go-live date for a key system. As a result, CSC faced a financial penalty and still did not have a new set of contract terms.

"We're engaged with those discussions," says CSC CEO Michael Laphen. "I think those discussions are going well. Given that it is a new Government, and given that there are new personnel involved at the executive level, I don't think it's unrealistic to assume that it would slip into the summer months to finalise that.

"We'll need to adapt and change to the customer's changes in directions, needs or new environment. Right now, we're moving forward. I think there are enough levers in a programme of this size that we can reach an equitable and amicable agreement for both the NHS and for CSC."

As for a financial penalty, Laphen is phlegmatic. "You need to keep in mind the context that it's £300 million out of £3 billion," he says. "So it's a manageable amount, I think, both for ourselves and for the NHS, if they choose to continue to move down that path."

**Michael Laphen: The CSC Chairman and CEO at the 'Technology for Society' day in Davos, January 2010. CSC's stake in NHS outsourcing has been significant.**



The public will protest at services being slashed back.

→ sign staff over to outsourcing partnerships wholesale, simultaneously slashing and 'creating' the same jobs – an accountant's dream scenario. Mr Cameron's 'Big Society' idea may really mean 'small Government', therefore – which is often a euphemism for 'major privatisation'. UK business leaders with outsourcing track records are already being brought closer to Whitehall, as we will see – consultancy without the pay cheque, perhaps – but Cameron himself seems to be looking to India for help.

#### "We have no money..."

Political realities are not lost on Fiona Spencer, director of the Shared Services Directorate at the Home Office. On 10th June she addressed a private meeting of outsourcing providers in London, which Professional Outsourcing attended.

"We have *no money*," she said – first when discussing immediate prospects, and again when setting out her longer-term predictions for Government sourcing. "The back office is under scrutiny," she continued. Spencer

then described how Whitehall is contracting, in both senses of the word: an environment of “drawing in, merging, centralising, and shrinking”. She said that ‘no money’ means quick cash savings and reduced investment, so projects need to be incremental. For the Home Office, the watchwords will be “outsource, joint ventures, lease, reuse, sweat the asset” and “make do and mend” (a familiar concept to CIOs). “So how can you help us?” she asked, before suggesting the answer: “The industry must provide ‘Tesco’ value,” in her words.

She concluded with a warning to the outsourcing industry: this shared exercise of enabling more efficient, innovative, consolidated government “will not be hugely profitable”.

#### Tough negotiations

Some of the Chancellor’s decisions have already started to hit the wider public sector. For example, there is an immediate freeze on “unnecessary consulting”, advertising and ICT spending of £1 million or more. In addition, Osborne has announced the establishment of the Efficiency and Reform Group (ERG) to help departments negotiate external contracts with suppliers.



Photo: Press Association

**The challenge for all outsourcing providers: if the Government offloads any services, private suppliers receive the backlash.**



**“As long as shared services remain only optional we can’t deliver the maximum benefit.”**

**John Torrie,  
UK CEO, Steria**

However, deciding what is ‘unnecessary consulting’ has as much to do with semantics as it does with hard cash: the Government, by law, must be platform-agnostic and favour no technology or supplier. As a result, it still has to rely on consultancy services to package recommendations under the guise of professional neutrality.

As a result, a few analysts remain upbeat about ‘big ticket’ prospects. According to a recent report by Ovum, the combined pressure of shrinking budgets, a requirement to reduce fixed and variable costs, and demand for better service by citizens will lead to increased outsourcing within public services.

But if Ovum is right and outsourcers do benefit from Government cuts, then that spells trouble for industrial relations as in-house staff fight to prevent outsourcers reducing public payroll headcount. Ovum warns there would also be widespread resistance to offshoring, which would mean savings being generated “through automation rather than labour arbitrage”. In that scenario, India becomes a less attractive partner, perhaps.

#### Political risk-taking

The NHS will be one battleground: “Private health already has a small role in the NHS, but we don’t want it to grow,” says Karen Jennings of public services union, Unison. “The danger is that private companies will become so powerful that they will be able to determine what services are provided and how much they charge.”

So there are prospects, but also caveats for all. Providers must focus on ‘de-risking’ the investment for the client – which, after all, is the general public. “If suppliers can generate a watertight business case while delivering a high-quality service at reduced cost, there is no reason to believe that the Government won’t be interested,” says John O’Brien, senior analyst at Ovum.

“Suppliers need clearly defined plans – for example, introducing flexible pricing and contracting, and shouldering more (if not all) of the initial financial burden,” says

O’Brien. No doubt, but that is only ‘de-risking’ the deal from a business standpoint, and does not include any political fallout for the provider, nor its impact on the public.

The reluctance to bankroll the kind of ‘big picture’ ICT programmes that characterised New Labour also means that the more entrenched or complacent suppliers to Government will now have to share the spoils with others.

#### Shared services on the rise

Shared services centres (SSCs) will be a defining feature of the new regime. As well as cost benefits, SSCs theoretically deliver consistency and quality of service by embedding best practices in processes that serve a large customer base. “Government will want to work with mature, collaborative partners that are prepared to share the risk and work together towards common outcomes,” says Ovum’s O’Brien. “Those partners need to be prepared for swift replacement if performance falters or cost creeps, as well as dramatically reduced termination penalties.”

Data centre consolidation is another, more proactive means of tackling the deficit as the Government shrugs off legacy technology – and legacy deals. “We have 130 data centres in central government. By rationalising down to between nine and 12 we can save £900 million in the first five years,” Government CIO John Suffolk told Professional Outsourcing at this year’s NASSCOM event in the Spring.

#### Overhauling the old machine

The way some public sector outsourcing is procured and paid for is certainly overdue for an overhaul. HP, which supplies the MoD and DWP among others, is already identifying its best contract terms with the intention of applying them retrospectively to some deals (See HP Vendor Profile). Canny vendors are being proactive rather than waiting for the axe to fall.

Analysis of ICT outsourcing by Compass Management Consulting found that UK public sector organisations are paying 40% or more above private sector rates, and that

#### • Accenture

While declaring that outsourcing in its US Federal and Health practices is enjoying growth, consultancy and services giant Accenture admits to some declines in its consulting revenues within the public sector, as a result of the current period of “continued uncertainty and challenges”.

“In the UK, it’s public knowledge that they are scrutinising all public expenditure very closely,” says CEO Bill Green. “You’ve got to go to the Prime Minister in order to get blessing, so as they continue to deal with their challenges, you have to have a good business case and a solid payback – and a near-term one that recognises that you are going to deliver value for money.”

“That said, there are still a lot of services that are provided and supported in the UK that need to go on, and so the business volume there will continue. But a lot of the opportunities for new things... will probably be put on hold in the UK, and maybe in one or two other countries.”

#### • Capita

Capita was widely quoted in the media, both pre and post election, as believing that the new austerity regime will offer it significant commercial opportunities.

“The public sector has been used to looking for efficiency savings across Government of two to three per cent and everyone had got used to that,” says Richard Marchant, Local Government Strategic Partnerships Director, Capita. “Now we’re looking at 10 to 15% reductions over two to three years. To put that in context, £11 spent today would be worth £8.50.”

“The challenge coming back to the private sector is for us to do lots more,” he adds. “Organisations are looking to extend contracts for a price reduction and we’re having sensible debates on that.”

better deal negotiation in the past could have created £6 billion of savings without affecting frontline services.

“Savings are being left on the table, and we’re hoping larger, more aggressive targets will be set sooner rather than later,” says Compass’ UK head Gary Bettis. He believes public sector purchasers must carry a burden of guilt: “Government departments are far too timid in their thinking and too cautious about transforming both sides of an outsourcing deal.”

This may be because Government procurement is traditionally seen as bureaucratic and monolithic. Where it *has* been more nimble and proactive, that has sometimes been achieved via expensive

**“The danger is companies becoming so powerful they determine what services are provided and how much they can charge.”**

**Karen Jennings,  
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consultancy services. In a bid to tackle this, the Cabinet Office is to assume responsibility for buying IT in Government, as the Office of Government Commerce (OGC) and public sector procurement agency Buying Solutions become part of the ERG.

The Efficiency and Reform Board is also due to expand. It guides the work of the ERG and is chaired jointly by Chief Secretary to the Treasury Danny Alexander, and Minister for the Cabinet Office Francis Maude. Government efficiency adviser Sir Peter Gershon, Tesco executive director Lucy Neville-Rolfe and former Logica CEO Dr Martin Read will all join the board.

"We wrote many of the recommendations on the operation efficiency plan with Martin Read," says Government CIO Suffolk, "and we passionately believe there are savings to be made in the way we undertake IT. When you have a burning platform, such as the economic debt, then everyone's behaviour has to change. The supplier community and the public sector have to work together to drive innovation and efficiency."

#### Getting control of costs

Francis Maude says: "The changes will bring together our operational capability to form a single, strong, but streamlined group to drive efficiency across Government. By taking this really tough stance on inefficiency and waste, we can tackle Britain's massive budget deficit and bring order back to the country's finances, while protecting vital frontline services. The review of ICT projects will be followed by a contract renegotiation exercise, which will be undertaken at supplier level and focus on those suppliers who have the largest overall revenues from UK public sector contracts."

The situation facing existing suppliers is simple: contracts will be renegotiated or canned. Vendors risk public opprobrium if they object or seek legal redress – and so it makes sense to be proactive in those negotiations, as HP has been.

There has been some tough talking by the Government already. On July 8, Maude met with the 19 largest ICT suppliers –



Top: Osborne in pensive mood as he contemplates the cutbacks. (PA Photos.) Bottom: Notes left on the lectern at a recent Home Office presentation to the outsourcing industry. (Professional Outsourcing.)



including IBM and Capgemini – to kick off a renegotiation process aimed at releasing savings. The Minister said: "I am laying down the challenge to major Government suppliers to ask them what they can do to take costs out of contracts."

Vendors such as IBM are absorbing public sector cutbacks in the US as well. IBM CFO Mark Loughridge, says: "They're reassessing the mix of their spend, not necessarily a reduction of the spend, towards projects that are yielding the best productivity and yield against their business cases. I would not project a big impact, but we've got to wait and see how this rolls out."

#### An old dog with new teeth?

In the UK, the Government is gritting its teeth – as well it might: Ovum calculates that 35 IT contracts must be renegotiated to hit savings targets. Already scrapped is a software licensing deal with Microsoft for the NHS Connecting for Health (CfH) programme. Ministers took the view there was no business case or budget.

This raises the question of which other projects may be abandoned. Some decisions have been straightforward, such as the scrapping of a £120 million contract for IT consulting at the MoD. Others have been less so: use of the ContactPoint child protection database was initially scaled back to keep it open, but the Government announced in July that it would be switched off on August 6. A few projects seem stalled: the £1.2 billion electronic borders scheme to protect the UK from illegal immigrants fell into disarray in July as the Government sacked its prime supplier, Raytheon.

#### The expense of closing programmes

Canning a deal is no guarantee of efficiency, however. For example, the £5 billion ID card scheme was scrapped to create "a Millennium Dome's worth of savings", according to Home Secretary Theresa May. In reality, that is not the case. Officials are renegotiating two contracts worth £650 million for parts of the scheme, while £250 million had already been spent developing the programme over eight years.

Some programmes became notorious for waste and mismanagement. New Labour totem the NHS National Programme for IT ran up a budget in excess of £12.7 billion. While NHS spending has been ring-fenced, there is an acknowledged need for efficiency savings of up to £20 billion by 2014. The NHS scheme is doomed in its current form, but the expense of breaking free from contracts would be massive.

As we have seen, shared services are being pushed into the spotlight as a new model for some Government sourcing initiatives – and may also be used to prevent contracts from being cancelled. SSCs make sense from an ICT point of view, because systems requirements between departments and Government organisations often overlap. "Most have a 90%-plus commonality of need from their IT services," says Compass' Bettis. "Standardisation reduces costs dramatically as providers deliver utility IT services to a range of clients using the same basic infrastructure."

#### Changing the culture

Such a move would mean a cultural shift in Government, however: "It's all about the smart re-use of technology. We have a mental block on that idea in this country," says Janet Grossman, chair of ICT association Intellect's Public Sector Council. "When I go around departments and authorities I see lots of ICT that has been well deployed, so why not reuse it? Enable it with Cloud Computing."

There is another cultural inhibitor to increased efficiency: the public's (and the public sector's) traditional hostility to UK jobs heading offshore. Nevertheless, there are signs the sector is becoming more open minded about it, according to the latest study from advisory firm EquaTerra, which found that 60% of public sector organisations are now open to the idea.

Several UK Government departments have already started offshoring IT jobs to lower the cost of operations, such as HMRC, which has an offshore outsourcing pilot in India with Capgemini – part of a wider push to save at least £110 million by

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**Francis Maude, Minister for the Cabinet Office**

2012. Elsewhere, NHS patient records and confidential medical notes for millions of UK citizens have been sent to India for processing by NHS Shared Business Services (SBS), a joint venture between the DoH and Steria.

#### A new era brings new rules

Speaking to Professional Outsourcing at NASSCOM, John Torrie, UK CEO of Steria, said: "Shared services is high on the Government agenda. The issue for us still is to try to press the Government for greater mandation [sic] of those services, because as long as they remain optional we can't deliver the maximum benefit. The fact that it is a joint venture and the Government allows control from both Government side and private sector is a very good model."

So there is new business to be won, but to clinch the deal the industry needs to play by new rules. Both the HMRC and NHS examples would have been considered political suicide a few years ago, but thinking the unthinkable is likely to characterise the coming months. The outsourcing industry would be well advised to join in before October 20 when the Government spending review breaks down where and when the axe will fall. ■

#### • Capgemini

Although Capgemini has multiple Government engagements – most notably at HMRC – the shoots of recovery are being seen outside the public sector. For its first quarter 2010, public sector revenues across the group accounted for 27.4% of the total, second only to manufacturing, retail and distribution on 28.7%. But for all that, it is the financial sector that shows most traction.

"The first sector that has resumed investing is banks," says CEO Paul Hermelin. "We all know that the finance industry has started to recover, but still acts a little like they used to act before the crisis."

"Demand is still relatively mediocre, but there are signs of a thaw," he adds. "We are seeing far less price negotiation and we are starting to see bigger systems integration deals in the pipeline. It has been mainly €2million to €10 million deals this last year, but now there is a surge for €10 million to €50 million deals."

This suggests a marked contrast in the way suppliers now address the private and public sectors.

• HP (See Vendor Profile this issue.)